BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2001-410-G – ORDER NO. 2002-223

MARCH 26, 2002

IN RE:	Application of Piedmont Natural Gas Company, Inc. for Expedited Approval of Authority to Implement an Experimental Natural Gas Hedging Program.	))))	ORDER APPROVING EXPERIMENTAL NATURAL GAS HEDGING PROGRAM

This matter comes before the Public Service Commission of South Carolina ("Commission") on the application of Piedmont Natural Gas Company, Inc. ("Piedmont") for expedited approval of authority to engage in an experimental natural gas hedging program.

Background

In Piedmont's last gas cost recovery proceeding, Docket No. 2001-4-G, the South Carolina Department of Consumer Affairs ("Consumer Advocate") presented testimony by Mr. Steven W. Ruback advocating the need for and describing the benefits of the implementation of a natural gas hedging program for Piedmont. These benefits included the stabilization of gas costs for South Carolina ratepayers. In that proceeding, Company witness Mr. Keith P. Maust agreed that a voluntary hedging program could be implemented by Piedmont and that such a program would act to stabilize gas costs for South Carolina ratepayers. In the Commission's Order No. 2001-886 issued in that Docket on August 30, 2001, the Commission directed Piedmont to file a hedging program for Commission approval within 60 days. In compliance with this directive, Piedmont filed an application for approval of a hedging program on September 21, 2001.

On February 19, 2002, the Commission issued a Notice of Hearing on Piedmont's application in which it set Piedmont's hedging proposal for an evidentiary hearing before the Commission on March 21, 2002 at 2:30 p.m. in the Commission Hearing Room. On February 26, 2002, the Commission issued its Order No. 2002-123 in this docket in which it established pre-filing deadlines for testimony and other hearing procedures.

The details of Piedmont's proposed hedging program were subsequently filed with the Commission on March 7, 2002, in the direct testimony and exhibits of Company witness Keith P. Maust.

On March 14, 2002, the Commission Staff filed the direct testimony of Brent L. Sires, Chief of Gas for the Utilities Department of the Commission Staff. No other party pre-filed testimony.

On March 21, 2002, in accordance with the Commission's scheduling order and the Commission's Rules of Practice and Procedure, the Commission conducted an evidentiary hearing. Piedmont was represented by James H. Jeffries IV and Kerry B. McTigue of the firm of Nelson, Mullins, Riley & Scarborough, L.L.P. The Commission Staff was represented by its General Counsel, F. David Butler. The South Carolina Department of Consumer Affairs was represented by its counsel, Hana Pokorna-Williamson.

Summary of Testimony

Keith P. Maust

Mr. Maust testified that in light of the recent dramatic volatility in the wholesale commodity cost of natural gas, Piedmont's experimental natural gas hedging program was being proposed to help stabilize the future costs to Piedmont's South Carolina customers. Mr. Maust indicated that the program supplemented certain natural "hedges" already in use by Piedmont, such as storage, Piedmont's purchased gas adjustment mechanism, deferred gas cost accounting and Piedmont's Equal Payment Plan. Mr. Maust testified that the possibility of implementing such a plan had been the subject of discussion in Piedmont's last gas cost recovery proceeding before the Commission in Docket No. 2001-004-G and that Piedmont had supported the filing of such a plan subject to certain conditions, including the following:

a. The gas-hedging plan should be filed with and approved by the Commission;

b. The gas-hedging plan should provide for the recovery from customers of all costs incurred by Piedmont in implementing and administering the plan;

c. If the Commission approved the gas-hedging plan with conditions, Piedmont should have the option of accepting the conditions or withdrawing the plan;

d. Piedmont should provide the Commission with periodic reports containing sufficient data to permit the Commission to evaluate the results of the gas-hedging plan;

e. Any future changes in the gas hedging plan approved by the Commission should apply on a prospective basis only;

f. All costs incurred by Piedmont in connection with the implementation and administration of the gas hedging plan, including administrative, systems, brokerage, consultant and margin requirements, as well as the costs of all gas purchased under the plan, should be deemed prudent and subject to full recovery.

Mr. Maust further noted that the Commission had approved the idea of a gas hedging plan filing by Piedmont in its gas cost recovery Order No. 2001-886, wherein the Commission stated:

> "We concur with the idea that Piedmont should file a hedging program for our approval. Hedging has been successfully used by South Carolina Pipeline Corporation to stabilize somewhat its cost of gas. We believe that Piedmont and its customers could enjoy some of the same benefits of such a program."

Mr. Maust attached to his testimony three documents which collectively constitute Piedmont's proposed experimental natural gas hedging program. Mr. Maust testified that in formulating the plan, Piedmont relied on the advice of and consulted with Risk Management Incorporated, a consulting firm with significant experience in risk management and financial hedging. According to Mr. Maust, Piedmont proposes a two-year rolling program which will go into effect on the first day of the month following Commission approval of the plan. Thereafter, the plan will continue in effect subject to the right of any party or the Commission to seek modification (with Piedmont's acceptance) or termination of the plan on a prospective basis only.

Brent L. Sires

Mr. Sires testified as to that portion of Piedmont's last gas cost recovery proceeding relating to the advisability of implementing a natural gas hedging program for Piedmont, and the Commission's requirement that Piedmont file such a proposal within 60 days of the date of its Order No. 2001-886 in that docket. Based on Mr. Sires' review of Piedmont's proposed hedging plan, he testified that, in his opinion, Piedmont had complied with the Commission's Order in filing its proposed hedging plan. With respect to the substance of Piedmont's proposal, Mr. Sires indicated that the Staff had reviewed Piedmont's proposed plan and had also met with Piedmont and representatives of the Consumer Advocate to discuss the details of the plan. Based on this review and meeting, the Staff is not recommending any change to the plan itself but does have a concern about the appropriate accounting treatment and recovery mechanisms associated with incremental personnel and related administrative costs of implementing the plan. According to Mr. Sires, the Staff believes that it would be more appropriate to recover these costs in the context of a general rate case rather than through Piedmont's gas cost recovery mechanism as is suggested by the language of Piedmont's plan. According to Mr. Sires, and as confirmed by Mr. Maust on the stand, Piedmont has agreed with the Staff's preference in this regard. The Staff supports Piedmont's ability to recover the other enumerated costs associated with its natural gas hedging program as part of the Company's gas costs as provided in the plan, subject to the Staff's right to ensure these costs are properly accounted for in any audit of the program. The Staff reserves the right to make adjustments to recognize any accounting irregularities that could result in its audit of the Hedging Program as a part of the docketed Piedmont Purchased Gas Adjustment and Gas Purchasing Policies annual review.

Findings, Conclusions and Discussion

The Commission, having carefully reviewed the application, the testimony of witnesses, its previous order in Docket No. 2001-4-G, and other matters of record, concludes that Piedmont's proposed experimental hedging plan is in the public interest and should be implemented in substantially the form submitted by Piedmont and subject to the provisions set forth therein. This conclusion is based on a number of factors discussed below.

First, the Commission has previously directed Piedmont to file a natural gas hedging program for approval by the Commission. Piedmont's proposed program meets the requirements of the Commission's prior order and should, therefore, be approved.

Second, based on the Commission's review of Piedmont's proposed program, the Commission concludes that the program is designed to reduce volatility in and stabilize to a degree the wholesale costs of natural gas paid by South Carolina customers served by Piedmont. This finding is supported by the Commission's prior actions and experience in approving a natural gas hedging program for South Carolina Pipeline Corporation.

Third, because Piedmont's proposed program operates off of pricing indices tied to future projected gas prices traded on a national exchange, and only provides for hedging with respect to a limited portion (up to 60%) of Piedmont's natural gas supplies, with only limited subjective discretion left to Piedmont, the Commission perceives no risk that hedging under the program will be unduly speculative in nature or subject to abuse by Piedmont so long as the requirements of the plan are followed.

Fourth, there is no potential for Piedmont to reap any direct economic benefit under its proposed hedging plan. Instead, the benefits of the plan will operate in favor of Piedmont's customers through stabilization of the wholesale commodity price of gas. Accordingly, it is appropriate for the costs of the plan to be borne by Piedmont's customers to the extent such costs are properly accounted for and incurred in accordance with the plan. The Commission , therefore, agrees with Piedmont and its Staff that all costs of the plan should be recovered, as gas costs, subject to review and adjustment by the Staff, through Piedmont's approved Gas Cost Recovery Mechanism except for incremental personnel and related administrative costs, the recovery of which may be sought as O&M costs in a general rate proceeding.

Fifth, under the plan, Piedmont will provide regular reports on the status of the program and the results of its hedging activities such that the Commission or any other interested party may seek modification or termination of the plan on a prospective basis. Final approval of modification or termination of the plan rests with the Commission.

IT IS THEREFORE ORDERED THAT:

1. Piedmont Natural Gas Company's proposed experimental natural gas hedging program is approved in accordance with its terms, as modified above.

2. All properly accounted for costs of Piedmont's natural gas hedging program incurred in accordance with the plan shall be treated as prudently incurred gas costs, subject to review and modification by the Staff, except for incremental personnel

and related administrative costs which may be recovered as O&M costs in a general rate proceeding, and shall be fully recoverable by Piedmont through its approved Gas Cost Recovery Mechanism. All properly accounted for costs include, in addition to gas purchased under the hedging program, systems, brokerage, and consultant costs and margin requirements; and

3. Piedmont's experimental natural gas program shall continue in effect until such time as it is either modified on a prospective basis or terminated on a prospective basis by further action of this Commission upon the motion of any party.

4. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

William Saunders

Chairman

ATTEST:

Gary E. Walsh

Executive Director

(SEAL)